



Plenary Session:

Understanding the Current Legal Economy

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Outline of Presentation

- Review of current market downturn
 - Summary of recent history
 - Impact of market downturn
 - Where we are now
 - Looking ahead in the near-term
 - Longer-term market shifts
- Key trends for you to watch
 - Changing makeup of law firms
 - Changing nature of legal practice
 - Law firm growth - domestic
 - Law firm growth -- global

Outline of Presentation (cont.)

- Implications for new (and not so new) lawyers
 - Short-term implications
 - Longer term - more career options
 - Career challenges
 - Demographic realities

Review of Current Market Downturn



Summary of Recent History

2007

- Strong seller's market
- Early trouble indicators emerge

2008

- Mixed legal market first half of year
- "End of the world" mentality by year end

2009

- Caution and fear dominate/realization rates collapse
- "Cut our way to profitability" as dominant strategy

2010

- Return to some stability, but not growth
- Some firms do well; others still in trouble

2011

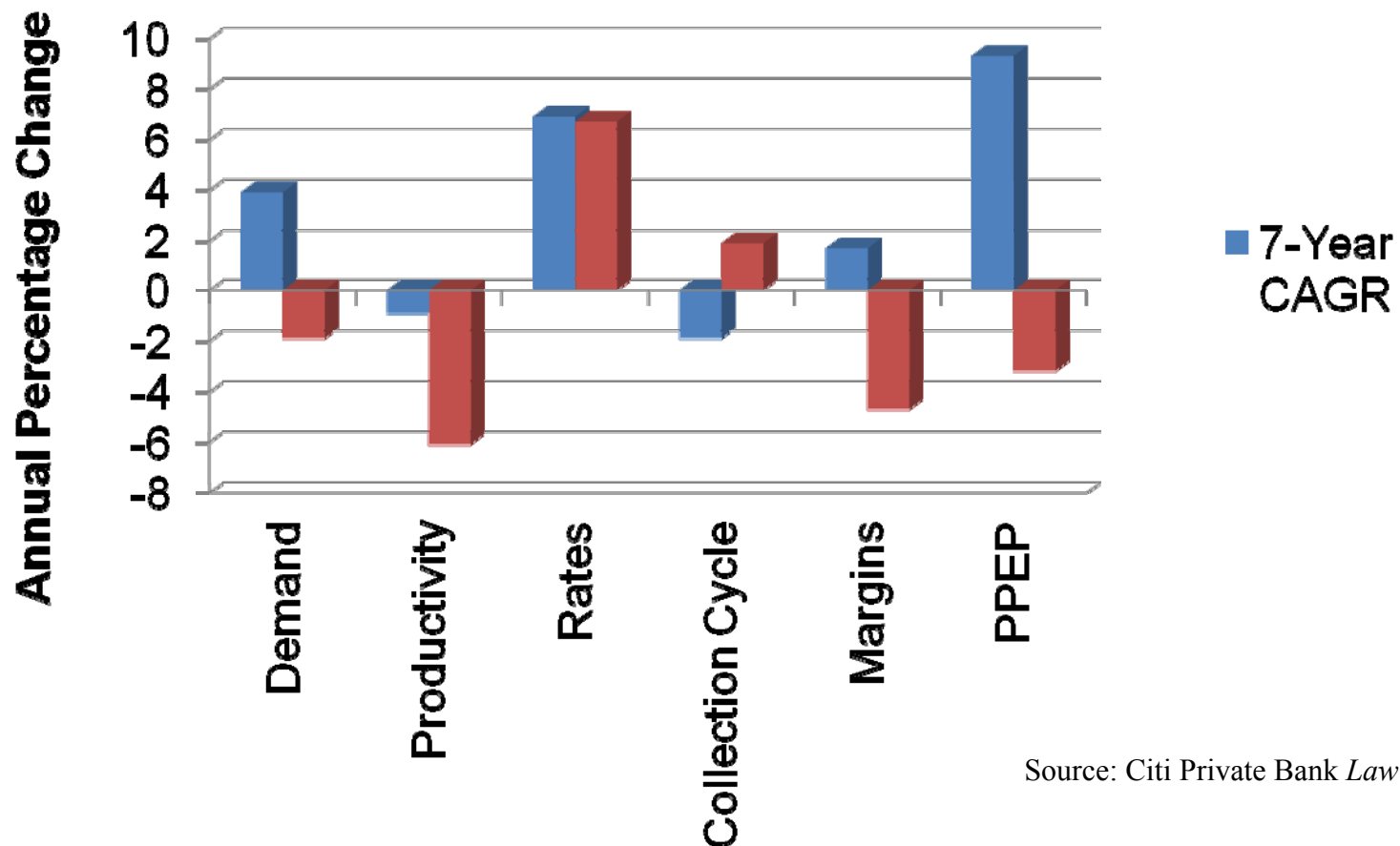
- Some demand increase, but growth remains sluggish
- Expenses begin to rise

2012

- Slow growth mode
- Where do we go from here?

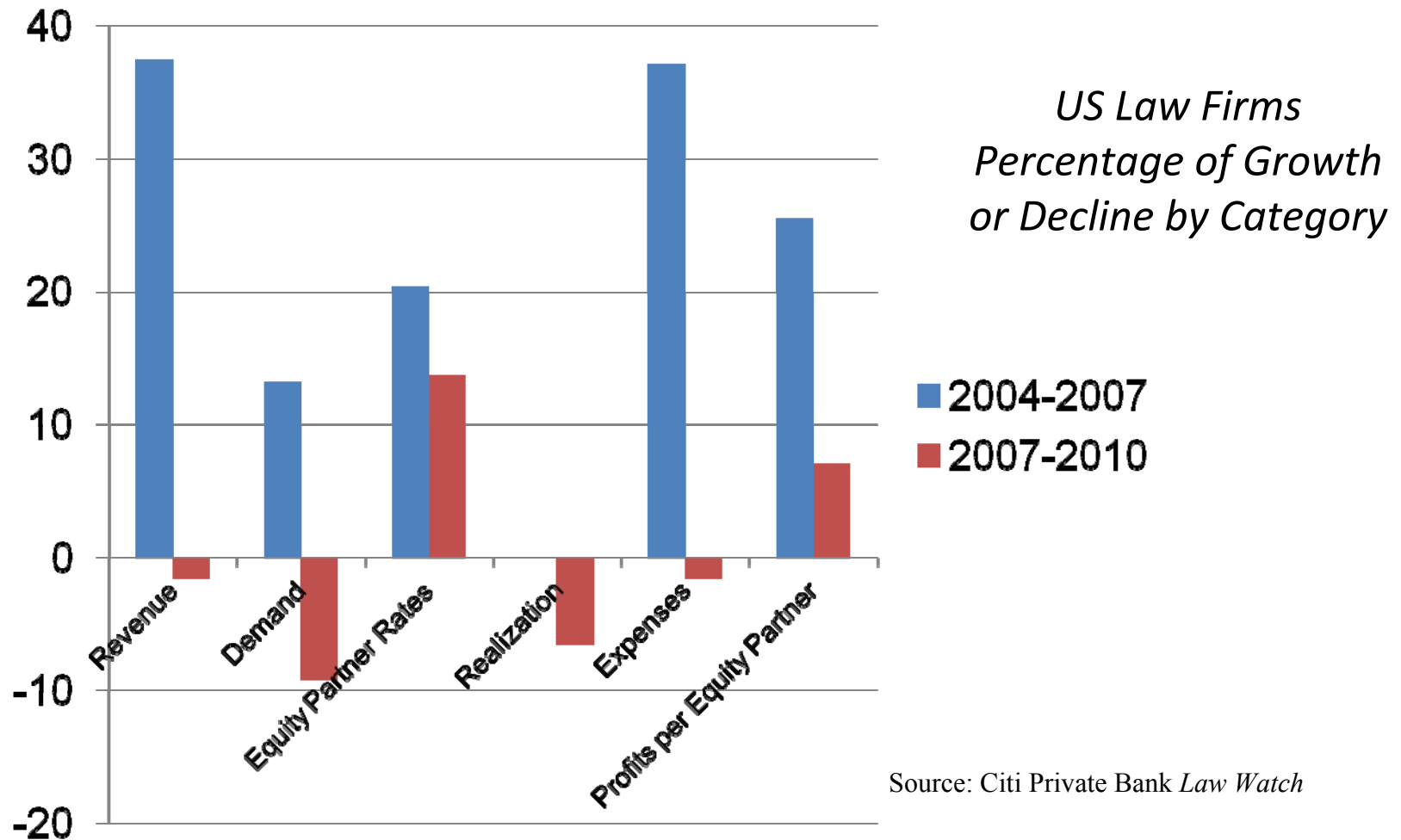
Impact of the Market Downturn

*Key Economic Indicators for US Firms
2008 vs. 7-Year CAGR*



Source: Citi Private Bank *Law Watch*

Impact of the Market Downturn (cont.)

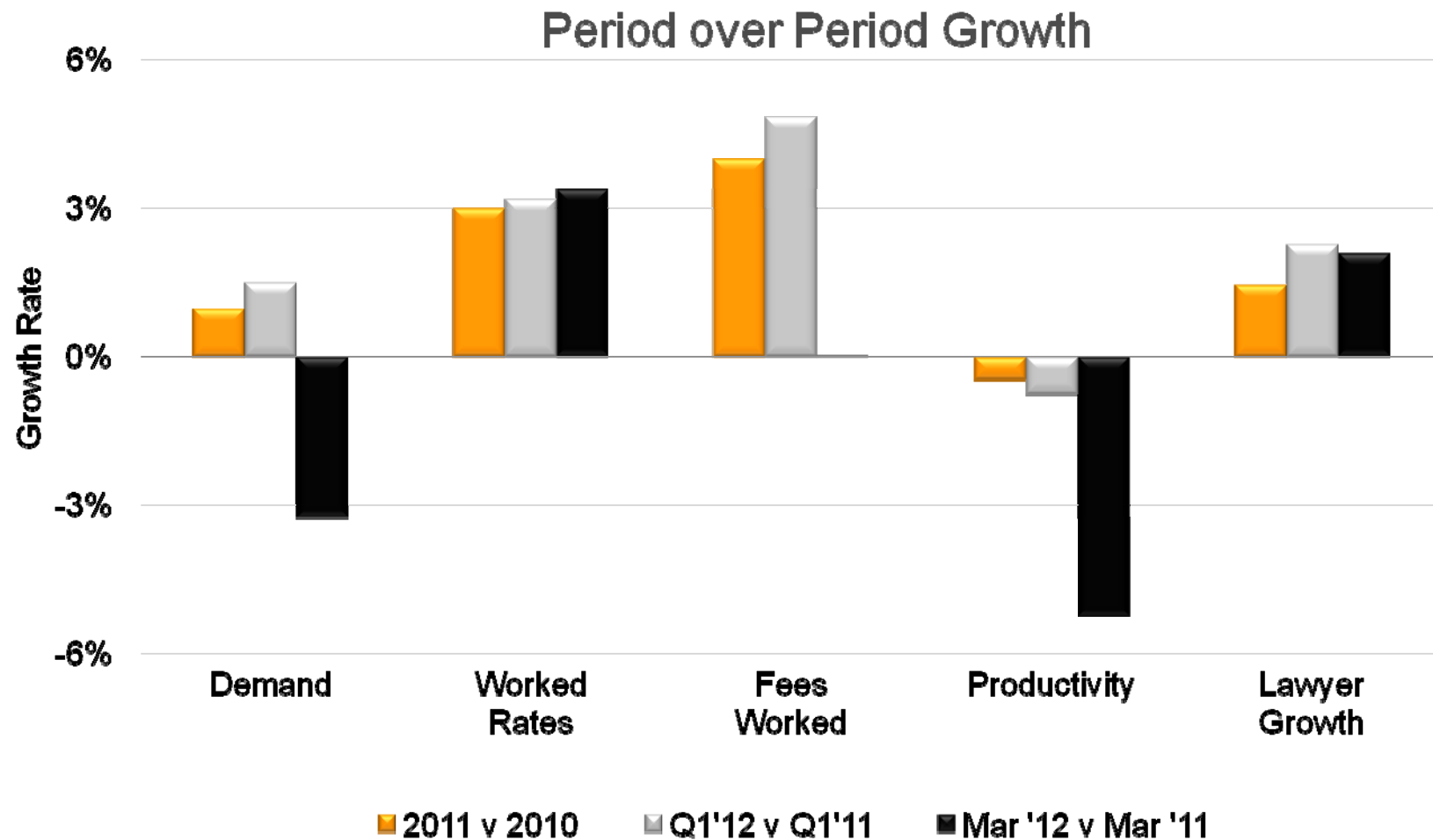


Where We Are Now

“Well, it’s one foot on the platform and
the other on the train . . .”

*“The House of the Rising Sun”
American Folk Song*

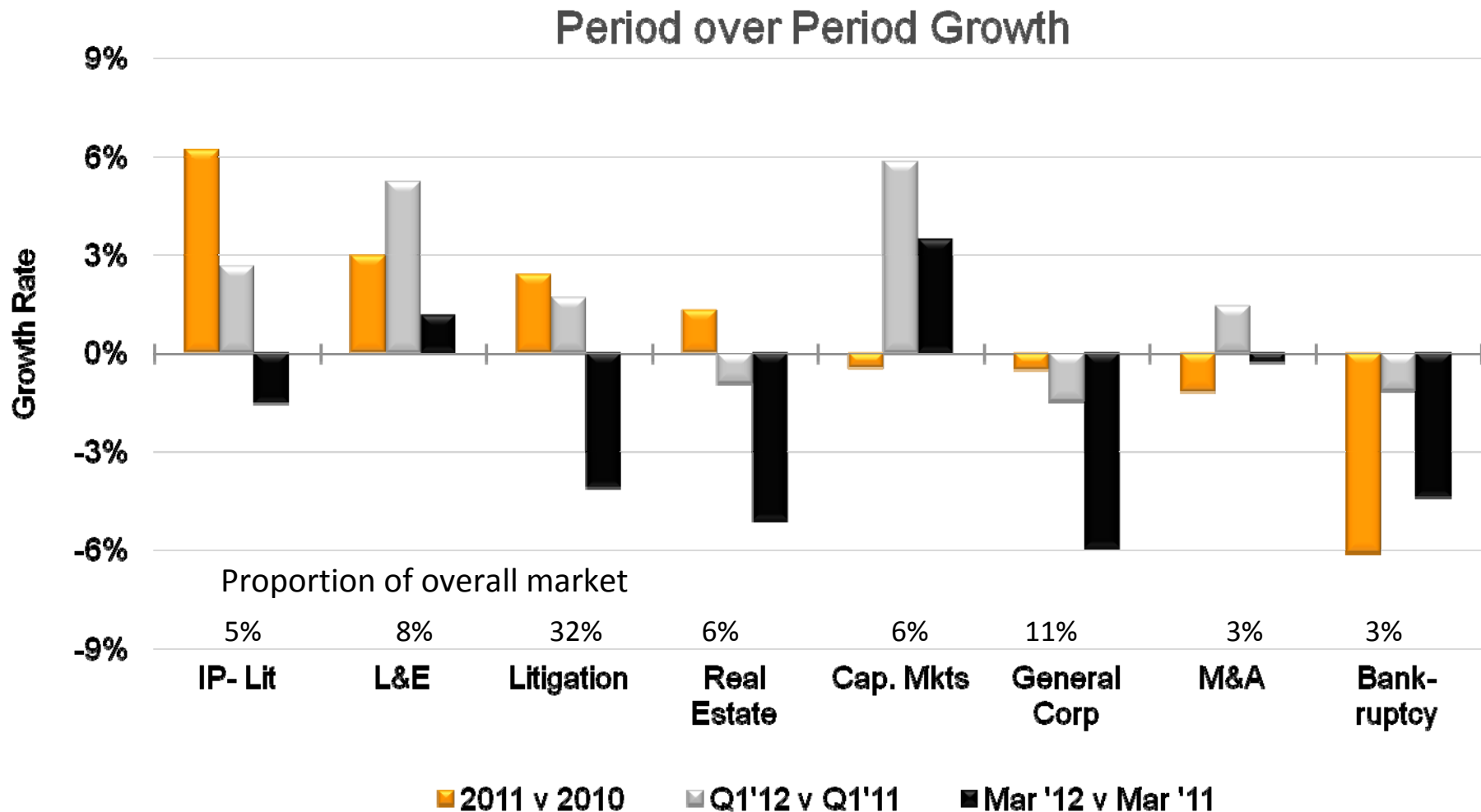
Key Performance Measures



Source: Thomson Reuters Peer Monitor

*All timekeepers

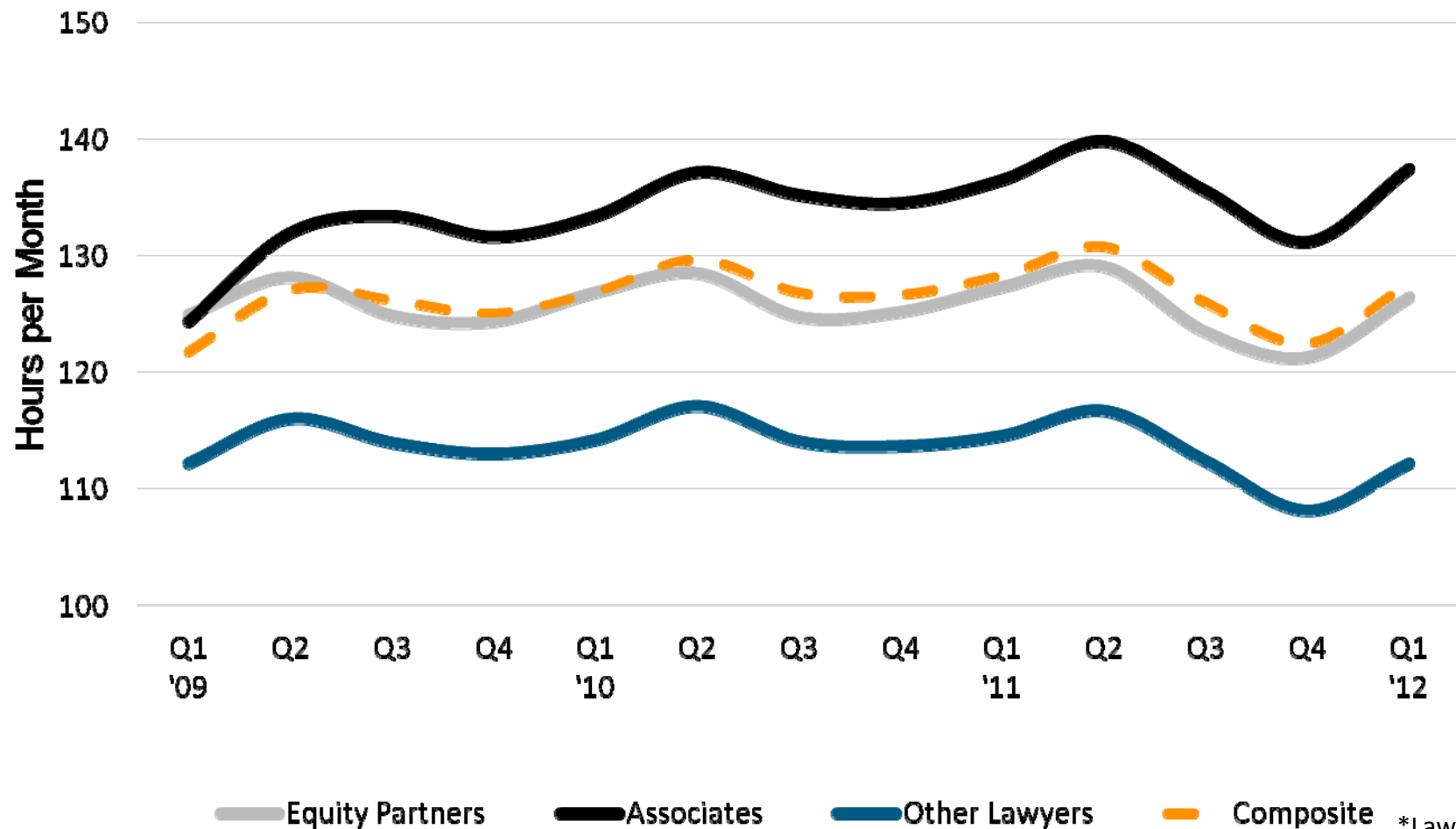
Demand Growth by Practice



Source: Thomson Reuters Peer Monitor

*All timekeepers

Hours Per Lawyer



Source: Thomson Reuters Peer Monitor

Where We Are: Summary

- Market ended 2011 with only modest overall demand growth and with slightly negative growth in productivity.
- Demand growth was essentially flat in key transactional and corporate practices.
- In Q1 2012, we saw encouraging (if modest) demand growth across most practices, signaling hopefully the start of a recovery.
- But there still remains about a 100-hour annual productivity gap as compared with the pre-recession period.

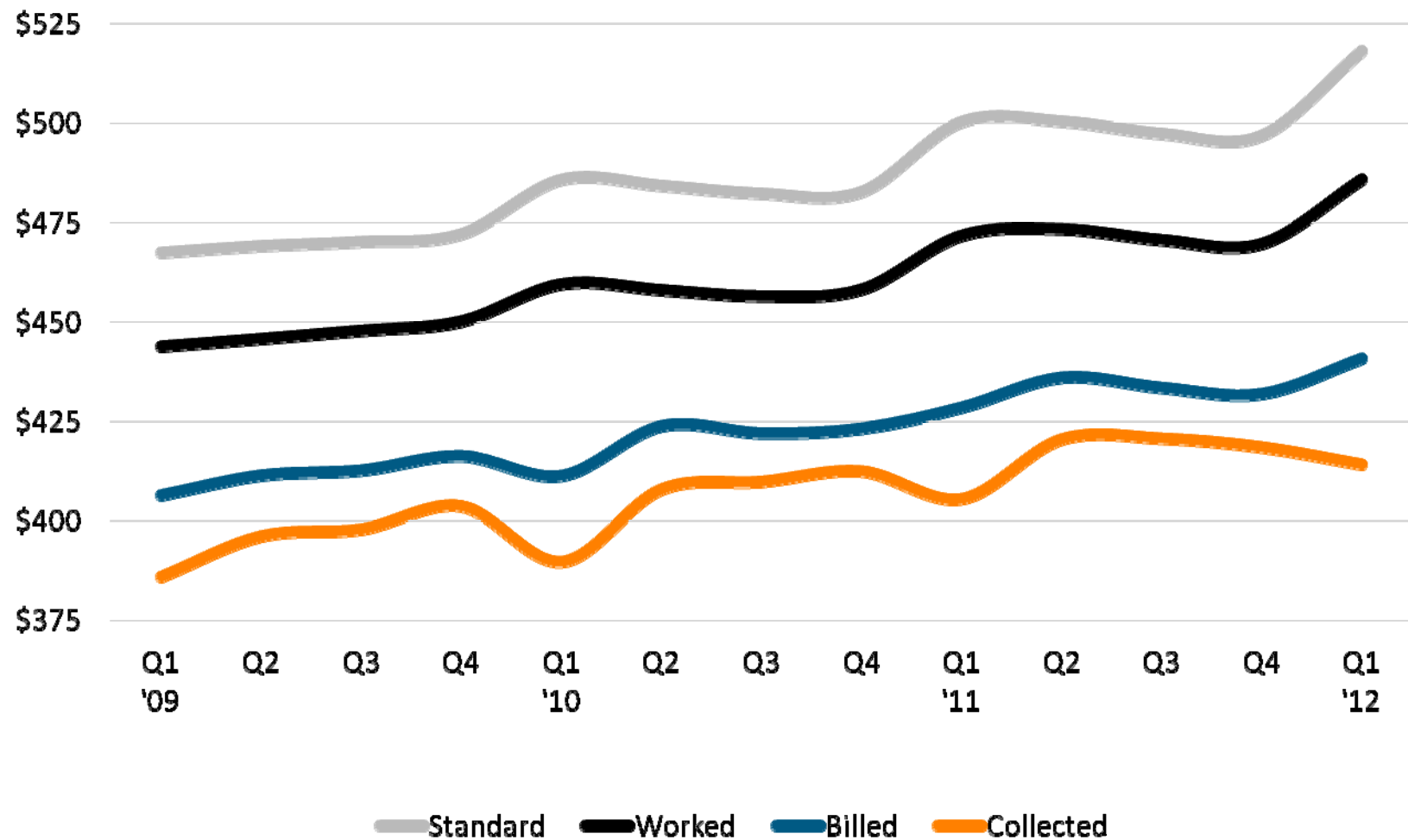
Looking Ahead

- Continued sluggishness in demand growth will put pressure on firms to maintain profitability at “acceptable” levels.
- This is particularly true given other economic factors that are also at work:
 - Continuing client resistance to fee increases and
 - Growing levels of direct and indirect expenses.

Resistance to Fee Increases

- Despite economic downturn, firms have generally sought to increase fees annually (though at a somewhat slower pace).
- Client resistance has been strong, however, with demands for discounts and other concessions.
- As a result, firm realization rates have fallen steadily over the past four years.

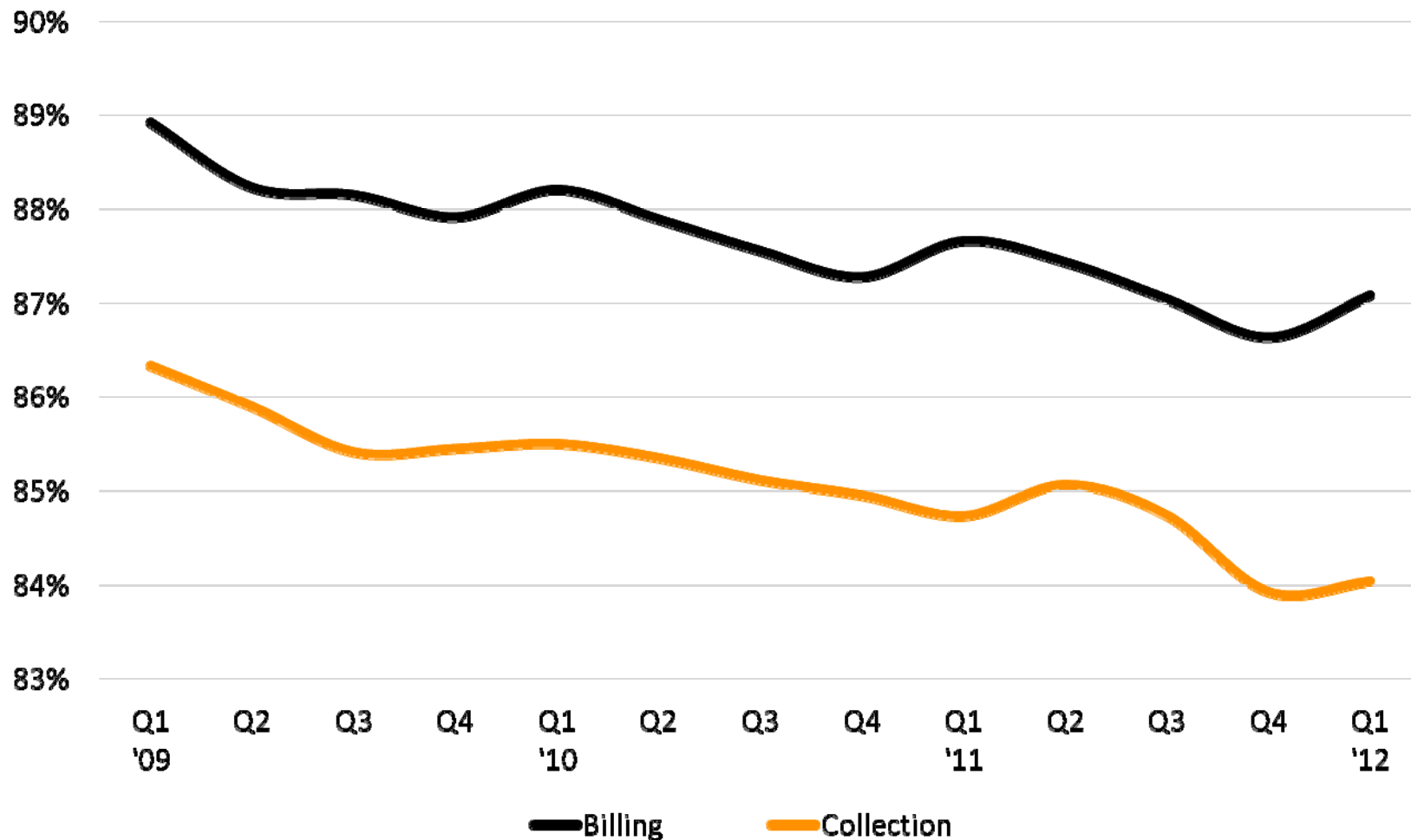
Rate Progression



Source: Thomson Reuters Peer Monitor

*Lawyers only

Realization Against Standard



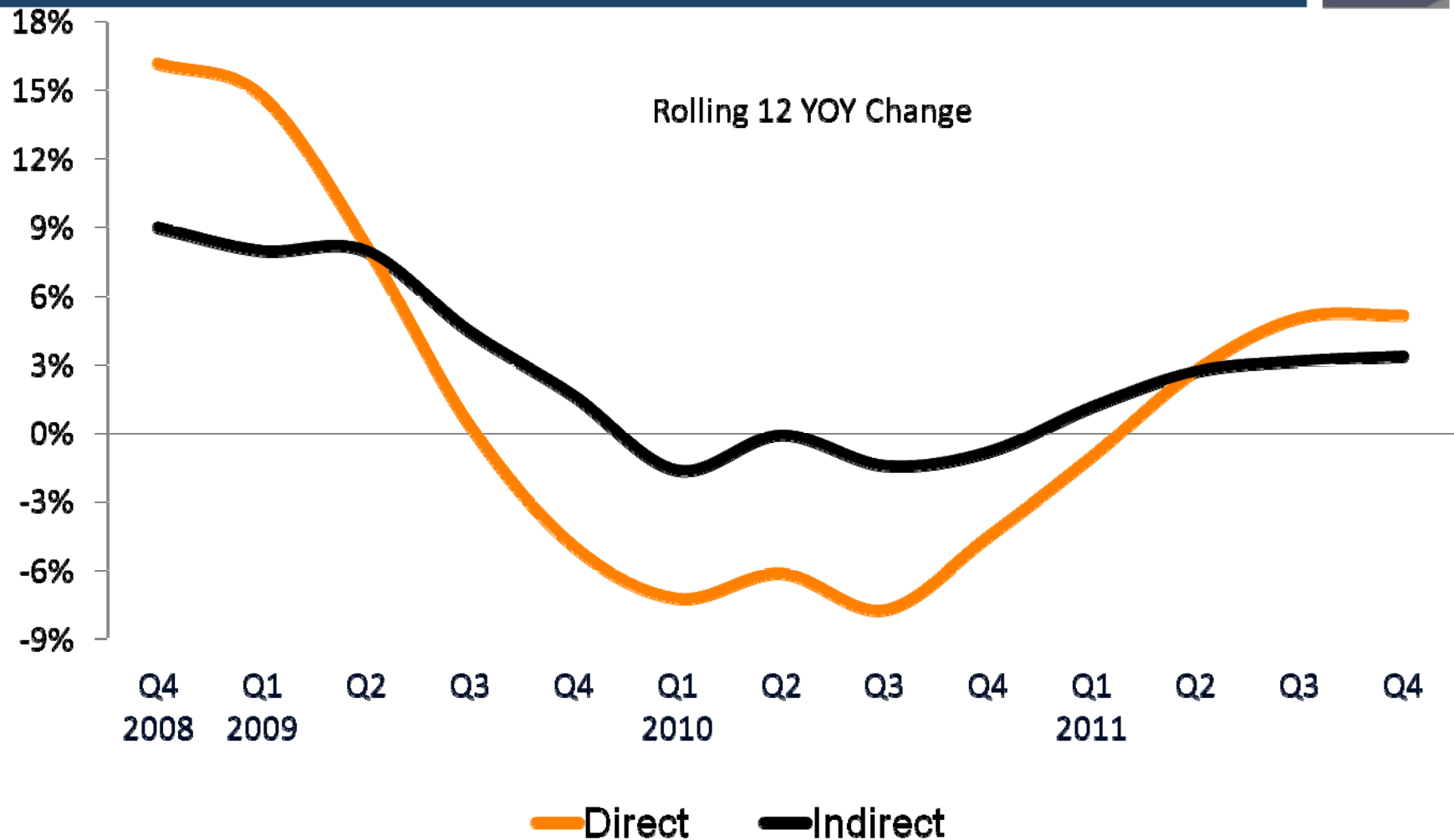
Source: Thomson Reuters Peer Monitor

*Lawyers only

Increasing Expenses

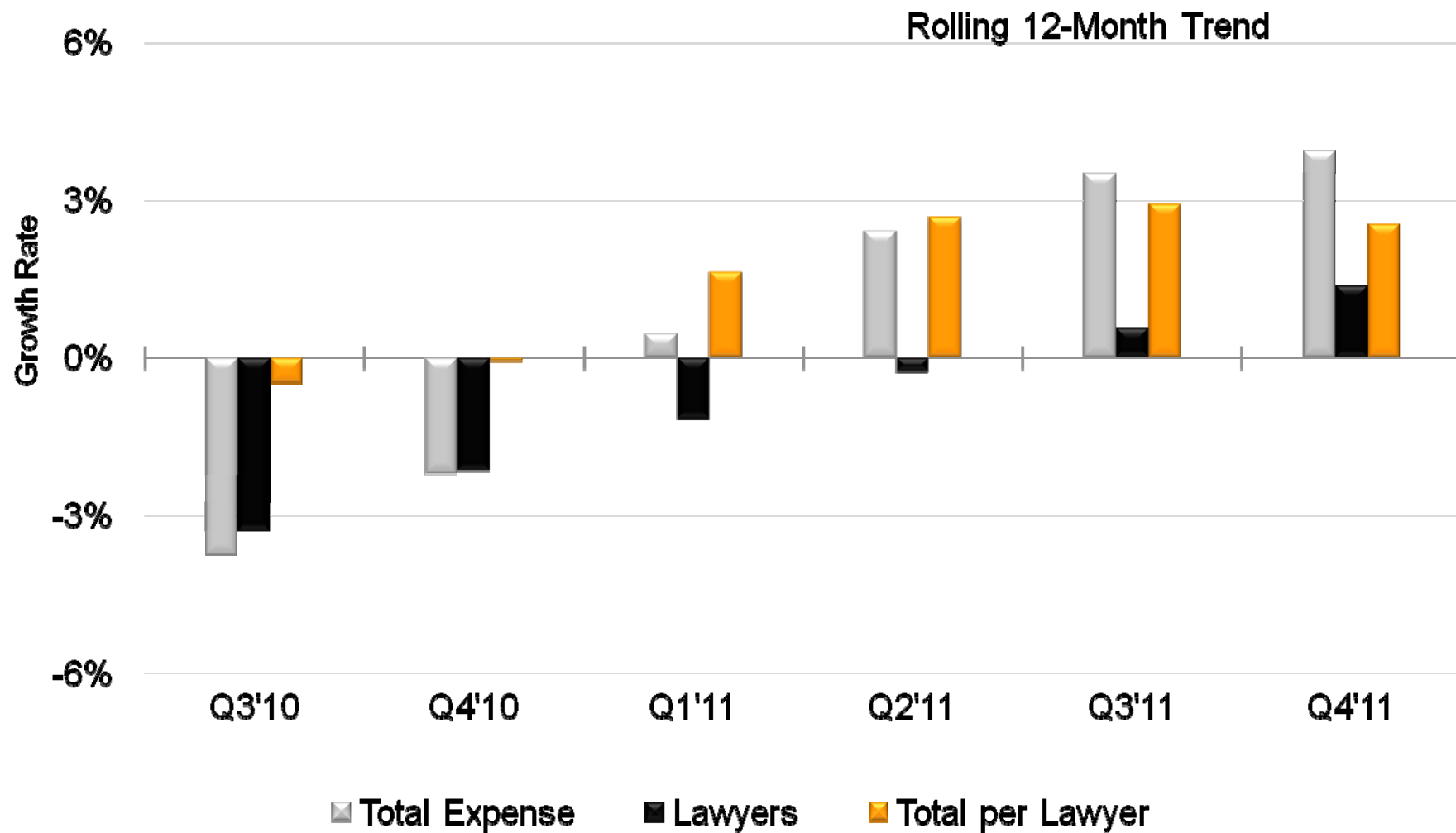
- Most firms cut expenses dramatically in 2009-2010, in large measure by reducing headcount.
- Since mid-2010, however, expenses have begun to creep up again because -
 - Some of the earlier cuts (e.g., layoffs) cannot be easily repeated;
 - Some of the earlier reductions were not really “cuts” but deferrals; and
 - Shift in competitive market environment is requiring investments in new systems/technologies/people.
- Recent increases have occurred in both direct and indirect expense categories.

Expense Growth



Source: Thomson Reuters Peer Monitor

Expense Growth by Lawyer



Source: Thomson Reuters Peer Monitor

Looking Ahead in the Near Term

- These factors - coupled with slow demand growth - will combine to make 2012 a tough year for law firm profitability.
- Overall, it is likely that profitability will rise only modestly across the market in the current year, at lower single-digit rates.
- While there will be variations depending on locations, practices, and client mix and some firms will find ways to continue to grow, overall the industry is likely to see only modest gains in 2012.

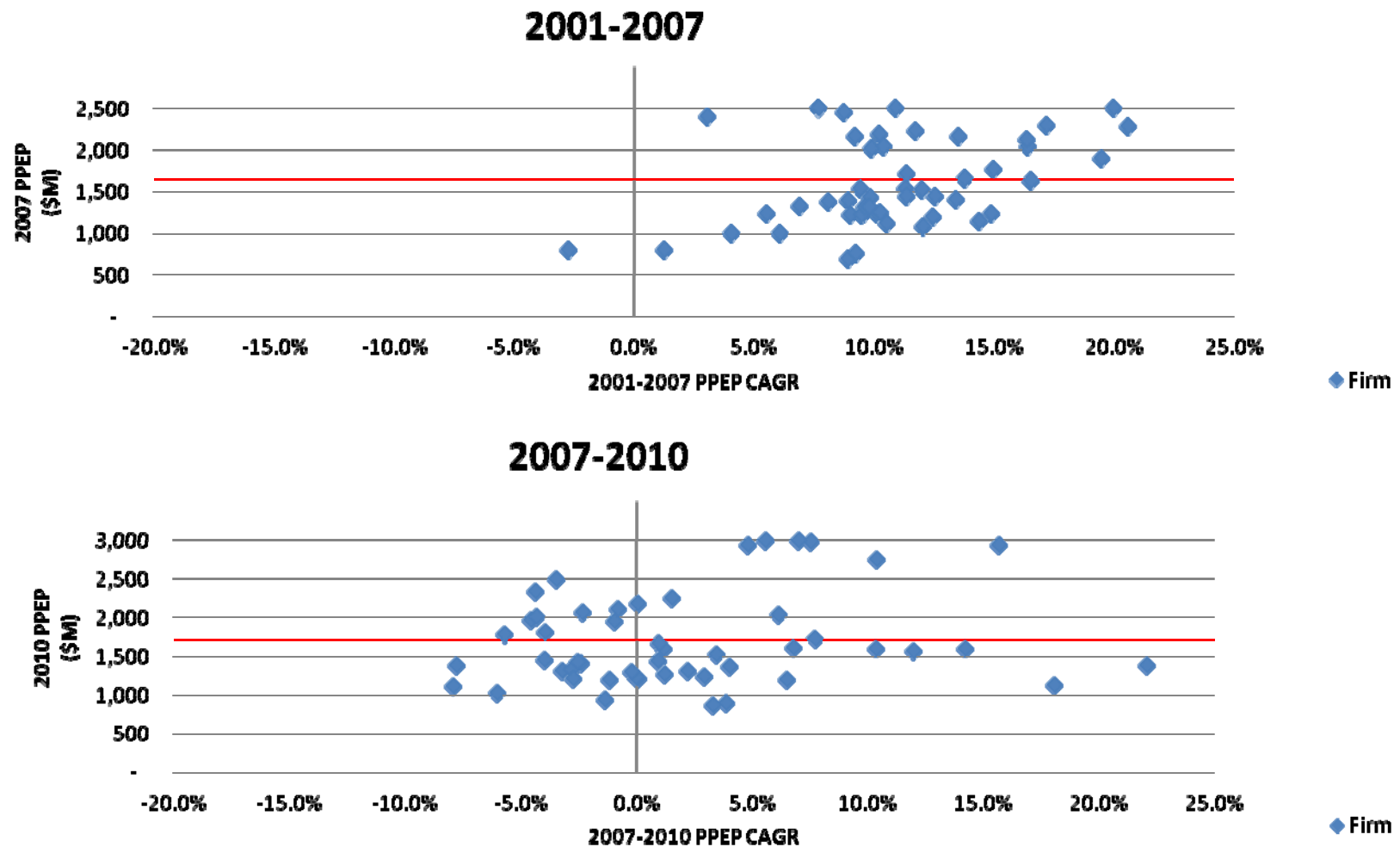
Longer-Term Market Shifts

- Shift to a **buyer's market** for legal services for the foreseeable future.
 - Will require a paradigm shift in the mindset of law firm leaders.
 - Will require a focus on efficiency and cost effectiveness in the delivery of legal services.
- Shift to a **much more competitive market** for the foreseeable future (one in which supply exceeds demand).
 - In a limited demand market, one firm can win only if another loses.
 - Stealing market share becomes essential.

Growing Market Segmentation

- Responding to a more highly competitive market (in which demand exceeds supply) and changed client expectations (as regards efficiency and cost effectiveness), firms have become much more strategically focused, and that in turn has led to a noticeable segmentation of the market.
- This segmentation - coupled with varying levels of management discipline - has resulted in a widening dispersion of firm financial performance.

Profit Performance Dispersion: Top-Tier Firms

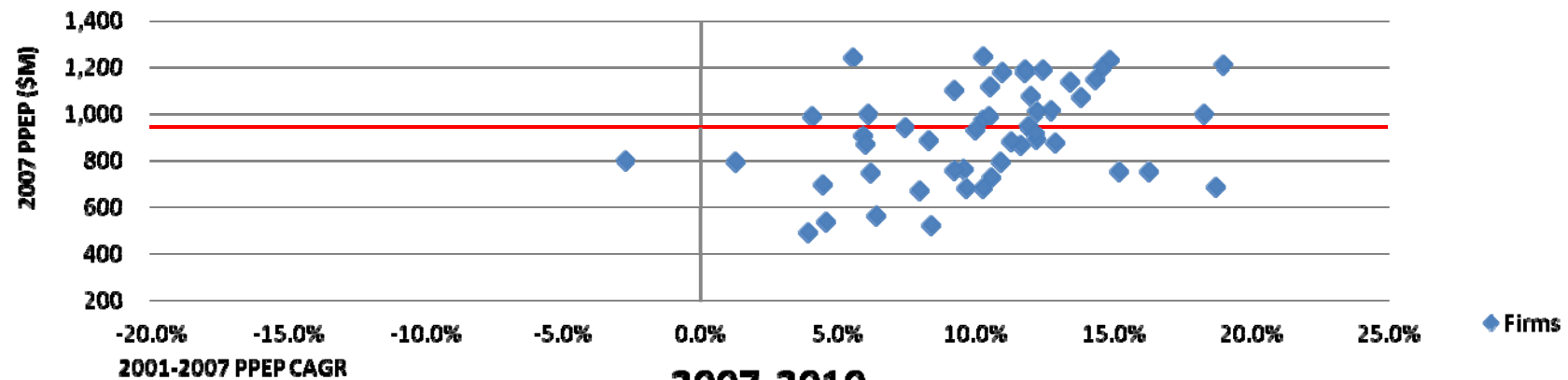


Sample size = 50 firms. Red line = sample average for each respective year.
Top range of PPEP in each chart capped to protect confidentiality.

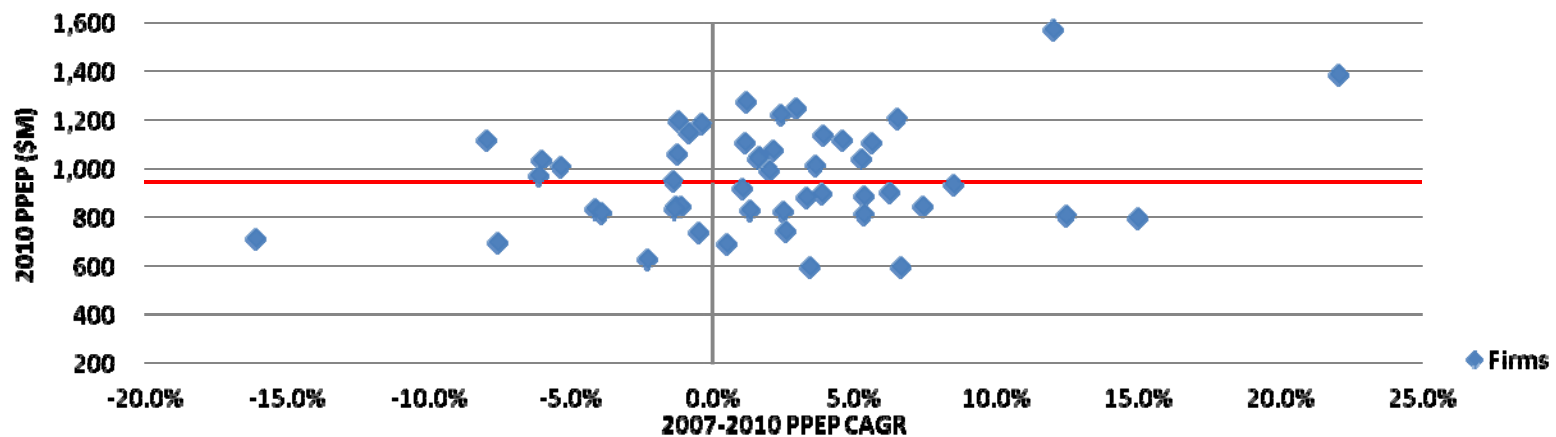
Source: Citi Private Bank *Law Watch*

Profit Performance Dispersion: Mid-Tier Firms

2001-2007



2007-2010



Sample size = 53 firms. Red line = sample average for each respective year.
Top range of PPEP in each chart capped to protect confidentiality.

Source: Citi Private Bank *Law Watch*

Growing Market Segmentation (cont.)

- This performance dispersion is apparent in all tiers of the market and is likely to continue.
- Moreover, the resulting performance levels are likely to harden over time making it more difficult for a firm to move significantly from one level to another.

Key Trends for You to Watch

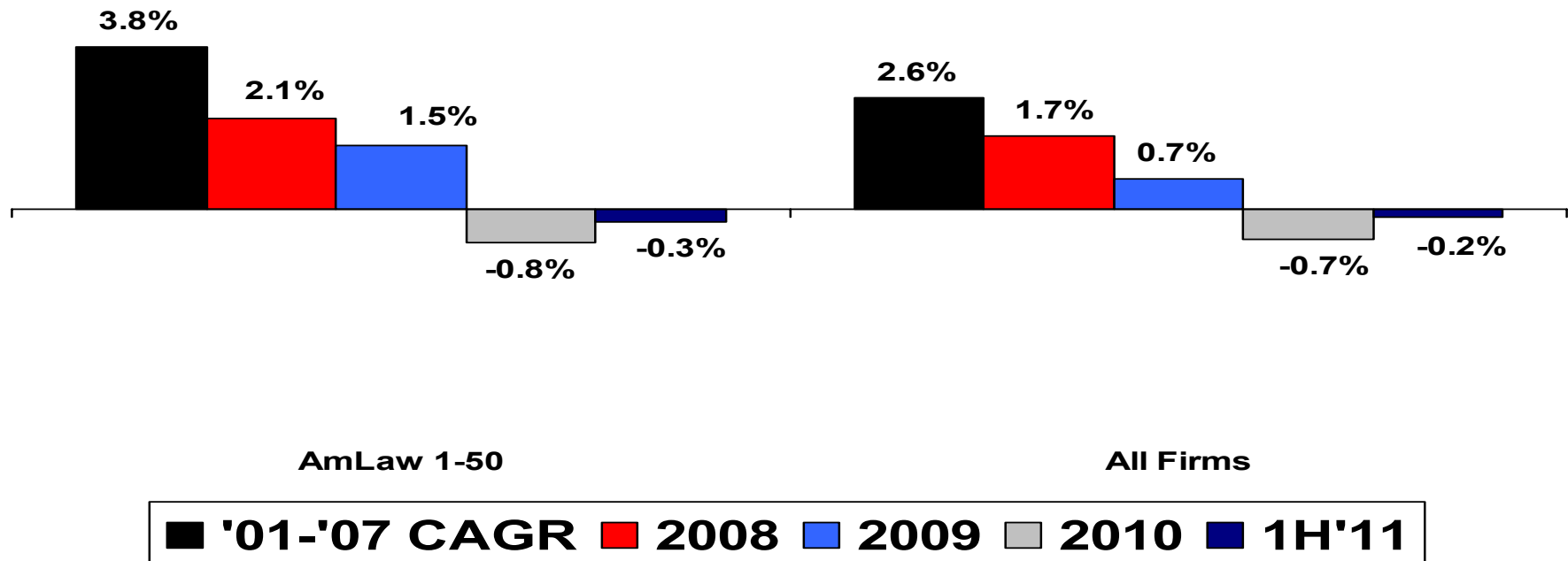


(1) Changing Makeup of Law Firms

- Reflecting new market realities, the shape and makeup of law firms has begun to change dramatically.
- First, the mix of lawyer categories in law firms is changing noticeably.
 - Growth in the equity partner ranks has slowed significantly since 2008.
 - Firms are hiring fewer traditional “partner track” associates than before the recession.
 - Firms now have a broad array of categories for non-partner track lawyers - staff attorneys, counsel, special counsel, contract lawyers, etc.

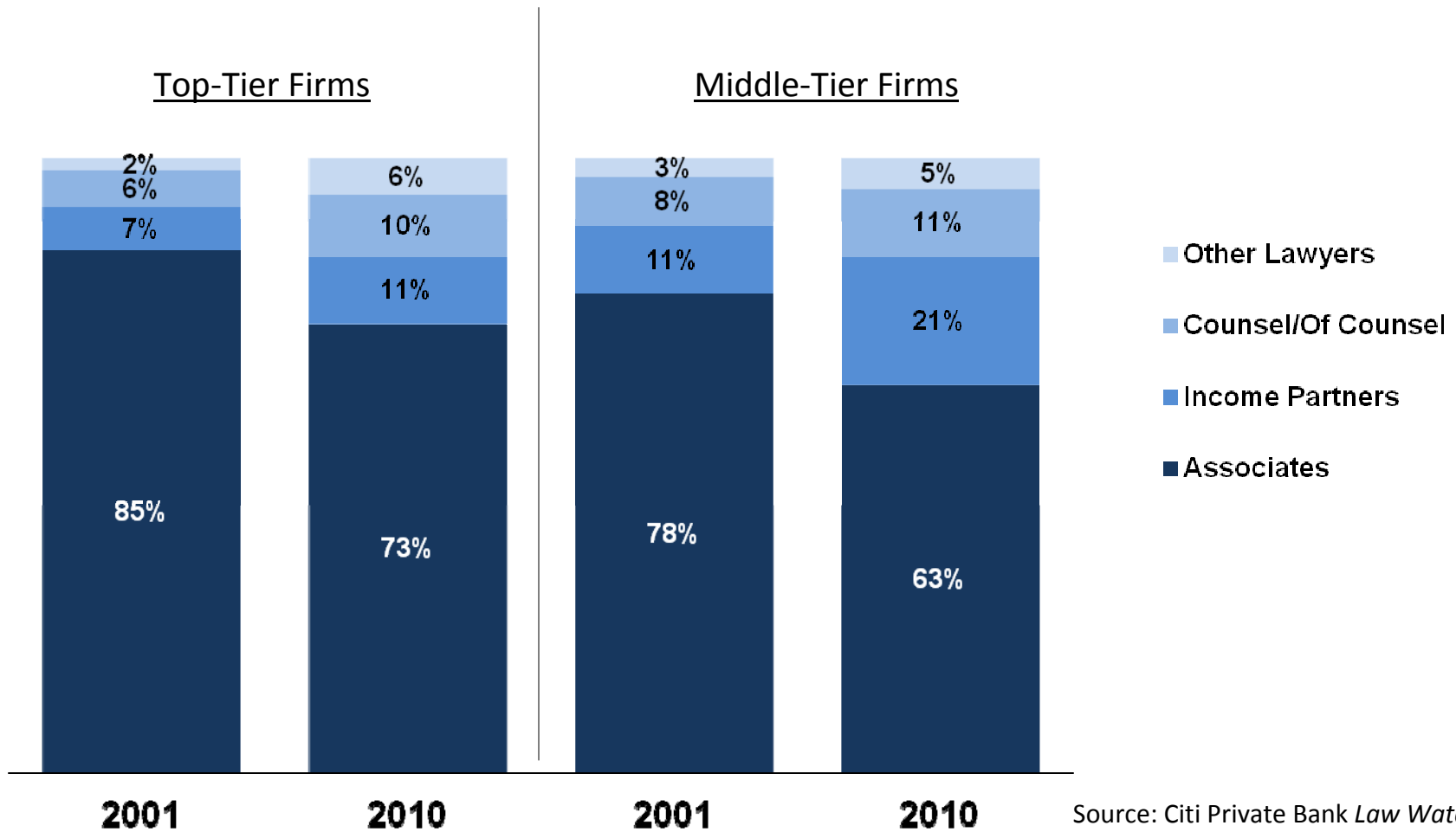
Changing Makeup of Law Firms (cont.)

Growth in Equity Partner Ranks (2001-2011 Q2)



Source: Citi Private Bank *Law Watch*

Changing Makeup of Law Firms (cont.)



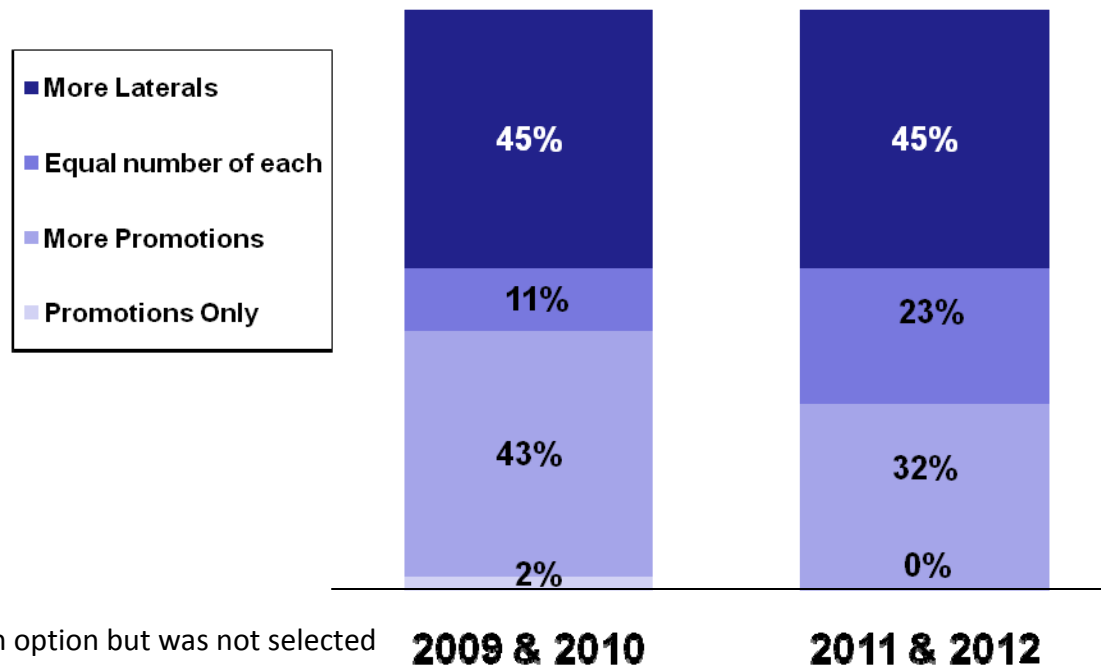
Changing Makeup of Law Firms (cont.)

- Second, the composition of equity partnerships is also changing.
- Traditionally, the overwhelming majority of law firm partners came up through the ranks of their firms. Today, that pattern is shifting.
 - Aspiring law firm partners are now finding new pathways open to them -- in-house jobs, government positions, work in other firms, etc.
 - This trend is reflected in the changing growth strategies of many law firms - a shift toward lateral acquisitions as a means of growing their equity partner ranks.

Changing Makeup of Law Firms (cont.)

Large Law Firm Partner Growth Strategies

Promotions vs. Laterals



Laterals only was an option but was not selected

of respondents = 47

Source: Citi Private Bank *Law Watch*

Changing Makeup of Law Firms (cont.)

- One consequence of the shift toward laterals and less traditional routes to partnership is that the average time to partnership appears to be lengthening.
 - Reviewing the class of new partners for 2012, the *American Lawyer* calculated that the average time to partnership was about 10-1/2 years, with 60% taking longer than that and only 15% attaining partnership in 7-1/2 years or less.
- Given the competitive dynamics of the current legal market, these changes in the shape and makeup of law firms are likely to be permanent.

(2) Changing Nature of Legal Practice

- Client insistence on efficiency and cost effectiveness in delivery of services has led to increasing disaggregation of legal services.
 - Insourcing
 - Downsourcing
 - Outsourcing
- One result: the emergence of new competitors in the legal market.
- Other results: incentives for law firms to use emerging technologies in innovative ways and increasing specialization.

Emerging New Competitors



Growth of Enabling Technologies

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C H A N C E

Online Services

Linklaters

blueflag

 **BusinessIntegrity**

PRACTICAL LAW COMPANY



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AN AFFILIATE OF ALLEN & OVERY LLP

Changing Nature of Legal Practice (cont.)

- Firms have also sought to respond to client expectations by -
 - Redesigning legal work processes to improve efficiency and drive down costs;
 - Developing new staffing strategies - including extensive use of “contract lawyers” and employment of non-partner track lawyers in lower cost locations (“downsourcing”);
 - Establishing firm-wide service centers, again in lower cost locations; and
 - Experimenting with non-hourly based pricing models.

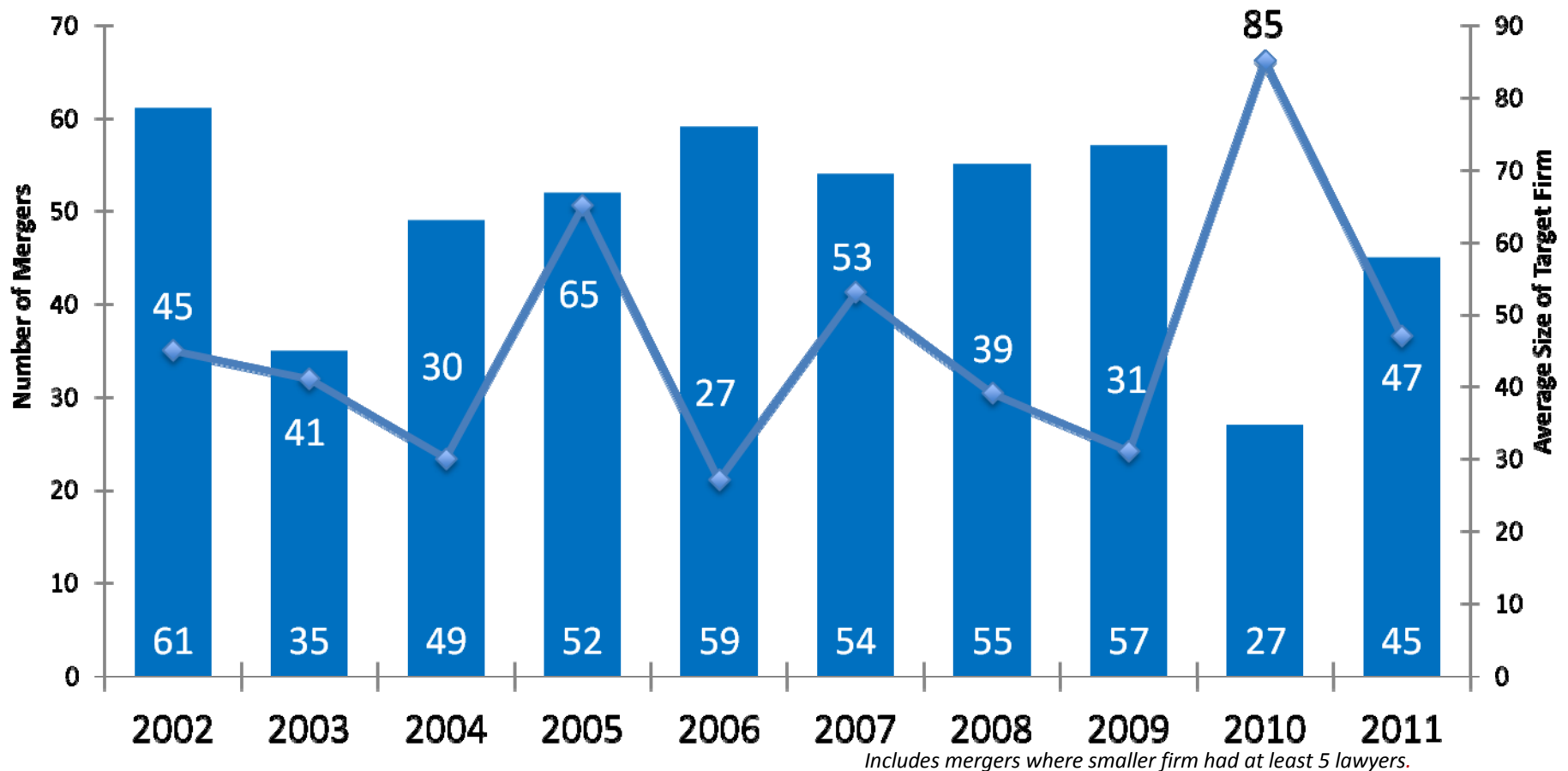
Changing Nature of Legal Practice (cont.)

- Finally, client driven disaggregation of legal services has resulted in renewed -- and expanded -- specializations of lawyers in ever smaller silos of practice.

(3) Law Firm Growth: Domestic

- Despite the slow economy (or perhaps because of it), law firm mergers rebounded strongly in 2011.
- There were 45 completed mergers last year involving US-based firms - a 67% increase over 2010 (a year that saw only 27 mergers).
- This pace is likely to continue in 2012. Indeed, 14 mergers of US firms have already been announced - almost double the number at this point a year ago.

US Law Firm Mergers 2002-2011



Source: Hildebrandt Institute Merger Watch

(4) Law Firm Growth: Global

- There was an explosion in interest in globalization exhibited by firms around the globe in 2011.
- Was reflected in number of mergers outside the US, which jumped to 54 last year (up from 44 and 48 in 2010 and 2009, respectively).
- Many of these mergers were quite large:
 - Squire Sanders with Hammonds (UK) - 1,275 lawyers;
 - DLA Piper with DLA Phillips Fox (Australia) - 4,000+ lawyers;
 - Ogilvy (Canada) and Deneys Reitz (South Africa) with the Norton Rose Group (UK) - 2,500 lawyers.

Law Firm Growth: Global (cont.)

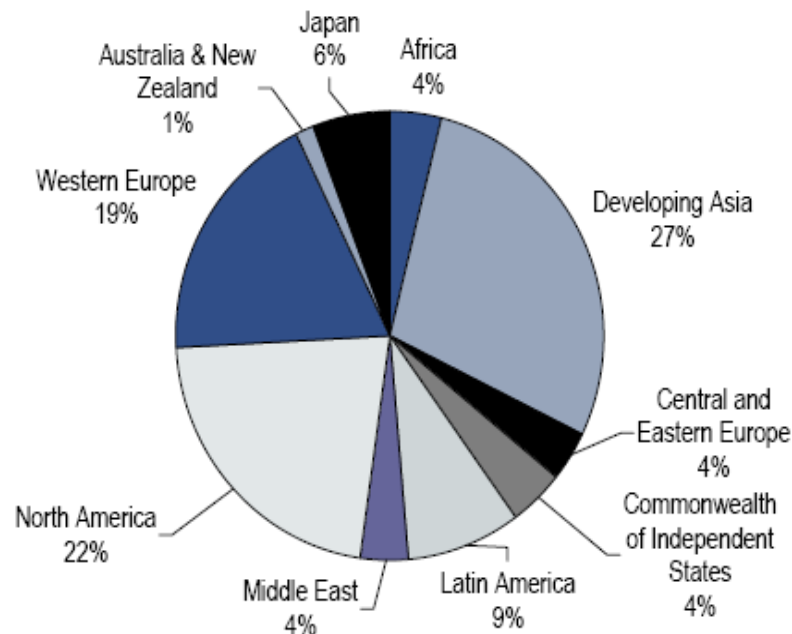
- Trend appears likely to continue in 2012.
- Indeed, a number of mergers have already been announced this year, including:
 - MacLeod Dixon (Canada) with Norton Rose Group (January 1);
 - Blake Dawson (Australia) with Ashurst (UK) (in March);
 - Mallesons (Australia) with King & Wood (China)(in March).
- And a number of top US firms that have not had large global footprints are now rethinking their global strategies.

Law Firm Growth: Global (cont.)

- All of this activity is being driven by demand growth in key emerging markets and business sectors around the world that have continued to thrive.
- Particularly true of the BRIC countries, but also includes growing industry segments like energy.
- At a deeper level, reflects the ongoing shift of world economic activity from the west and north to the east and south.

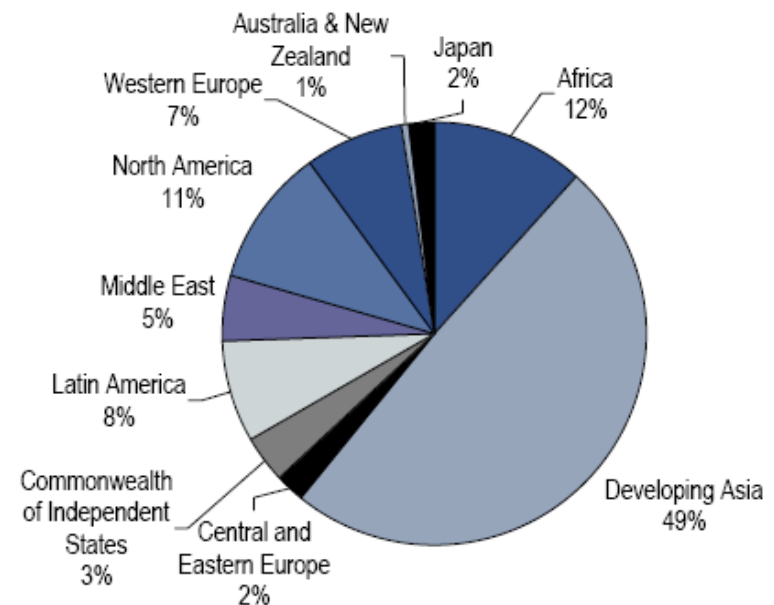
Long-Term Shift of World GDP Growth

Composition of World Real GDP 2010



Note: GDP Based on PPP Valuation of Country GDP (CID)
Source: IMF World Economic Outlook; Citi Investment Research and Analysis

Composition of World Real GDP 2050



Note: GDP levels calculated taking regional GDP (CID) data for 2010 from IMF, then calculating forward to 2050 using regional real growth rates based on Citi forecasts
Source: IMF World Economic Outlook; Citi Investment Research and Analysis

The background of the slide is a dark blue night sky. In the lower portion, there is a silhouette of a city skyline, including a prominent domed building. Numerous hats of various colors (green, brown, grey) are floating in the air, as if caught in a breeze. The title text is overlaid on the upper left of this background.

Implications for New (and Not so New) Lawyers

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Short-Term Implications

- In the short-term, the hiring market will remain depressed.
 - Given the drop in demand growth during the second half of 2011, most firms will continue to be very cautious in 2012 despite some market growth.
 - Hiring quotas - for both associates and summer associates -- are likely to remain well below “normal” for another year or so.
- Impact will be somewhat different for different tiers of law schools, but no one will be completely immune.

Longer Term - More Career Options

- If ultimate goal is a law firm partnership, there are now more ways to get there than ever before.
 - Firms are increasingly open to partner candidates with wide varieties of experience - both in law firms and elsewhere.
 - The former prejudices against in-house or government experience have faded as lateral movement has increased.
- The current highly competitive market values and favors experience and expertise, wherever acquired.

Longer Term - More Career Options (cont.)

- In-house positions are more attractive than ever before, many offering career paths quite competitive with law firms.
- Proliferation of new kinds of legal service providers also offer a new range of career option.
- Lawyers who are capable of functioning successfully in a global market - through appreciation of global trends, facility with foreign languages, and cultural sensitivity - will be in high demand.

Longer Term - More Career Options (cont.)

- The profession has become more of a meritocracy than ever before. With increased focus on performance, there are more opportunities for new lawyers who work hard and achieve results. Advancement is no longer about “waiting your turn.”

Career Challenges

- Given the current pace of change in the legal market, the one certainty is that every lawyer's career is likely to take surprising turns.
 - Most new lawyers today will change jobs several times and may change careers more than once.
 - The key quality will be flexibility - in the Darwinian sense.
- The job of legal education must be to prepare lawyers to re-invent themselves throughout their entire careers to keep pace with the rapid evolution of legal services.

Selected New Practices Since 1970

- Class Action Litigation
- Product Liability Litigation
- IP Litigation
- White Collar Criminal Law
- Securities Fraud Litigation
- Employment Law
- Privacy Law
- Healthcare Law
- Telecommunications Law
- Securitization
- Privatization
- Hostile Takeovers
- Cross-Border Transactions
- Environmental Law
- Energy & Natural Resources
- Land-Use Law
- Endangered Species Law
- Toxic Substances
- Internet Law

Career flexibility is key.

And Finally - Demographic Realities

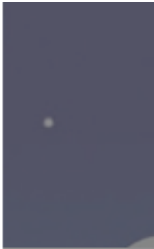
- Demographically speaking, it's a good time to be a young lawyer -
 - “Baby boomers” (born between 1946 and 1964) constitute half of all practicing lawyers in the US and an even higher percentage of law firm partners;
 - “Gen Xers” (born between 1965 and 1980) account for about 20% of all practicing lawyers.
- Reflects a broader issue in the US workforce as a whole.
 - Over the next 20 years, some 80 million “baby boomers” will retire, and there are only 46 million “Gen Xers.”

Looking Ahead

- So, while the short-term hiring picture may be bleak, the longer term prospects for new lawyers are more encouraging.
- But the new market realities mean that we need to re-think -
 - How we prepare young lawyers for practice;
 - How we help them set appropriate expectations about their careers; and
 - How we provide ongoing support for re-training and re-tooling throughout lawyers' professional lives.

A Final Thought . . .

In a time of drastic change, it is the learners who inherit the future. The learned find themselves equipped to live in a world that no longer exists.



Thank you.

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